

STATE OF NEW YORK

DIVISION OF TAX APPEALS

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In the Matter of the Petitions	:	
of	:	
M & B APPLIANCE, INC.	:	
AND MAN M. MUNJAL AND INDER S. BINDRA,	:	DETERMINATION
AS OFFICERS	:	
for Revision of Determinations or for Refund	:	
of Sales and Use Taxes under Articles 28 and 29	:	
of the Tax Law for the Period December 1, 1979	:	
through August 31, 1983.	:	

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Petitioners, M & B Appliance, Inc., and Man M. Munjal and Inder S. Bindra, as officers, filed petitions for revision of determinations or for refund of sales and use taxes under Articles 28 and 29 of the Tax Law for the period December 1, 1979 through August 31, 1983 (File Nos. 801653, 802764, 802765 and 802766).

A hearing was commenced before Jean Corigliano, Administrative Law Judge, at the offices of the Division of Tax Appeals, Two World Trade Center, New York, New York, on May 1, 1989 at 2:15 P.M. and continued to conclusion on December 14, 1989 at 10:15 A.M., with all briefs to be submitted by May 15, 1990. Petitioners appeared by John R. Serpico, Esq. The Division of Taxation appeared by William F. Collins, Esq. (Anne W. Murphy, Esq., of counsel).

ISSUES

- I. Whether the books and records made available to the Division by petitioners were adequate for the purpose of verifying taxable sales and the tax due on those sales.
- II. Whether the Division properly determined that a percentage of petitioners' claimed sales for resale were taxable, based upon third-party verification of purchases.
- III. Whether petitioners satisfied their burden of showing that certain sales were made to tax exempt organizations or persons or for export and thereby not subject to sales tax.

### FINDINGS OF FACT

On September 20, 1984, the Division of Taxation ("Division") issued identical notices of determination and demands for payment of sales and use taxes due for the period December 1, 1979 through August 31, 1981 to petitioners, M & B Appliances, Inc. ("M & B"), Inder S. Bindra and Man M. Munjal, assessing sales tax due in the amount of \$332,274.56 plus a civil fraud penalty in the amount of \$166,137.28 plus interest. The notices issued to Mr. Munjal and Mr. Bindra explained that each was personally liable as an officer of M & B for taxes determined to be due from the corporation. On August 27, 1985, the Division issued to petitioners notices of determination and demands for payment of sales and use taxes due for the period September 1, 1981 through August 31, 1983, assessing sales tax due in the amount of \$779,052.35, plus penalty and interest. Again, Mr. Munjal and Mr. Bindra were assessed as officers of M & B.

On October 7, 1985, the Division issued to petitioners notices of assessment review, revising the notices issued on September 20, 1984 by reducing the tax due to \$296,094.32 and substituting a penalty of \$74,023.58 in lieu of the previously asserted civil fraud penalty.

Petitioner M & B, by one of its officers or appointed representatives, executed a series of five consents having the effect of extending the period of limitation on assessment for the period December 1, 1979 through August 31, 1981 to any time on or before September 20, 1984. According to the field audit narrative, an assessment was issued on September 20, 1984 because a waiver of the period of limitation could not be obtained for a later date. Likewise, the civil fraud penalty was imposed "to protect the Department's possible claim." Subsequently, M & B executed three more consents, extending the assessment period for the period December 1, 1979 through August 31, 1982 to September 20, 1985.

The notices of determination under consideration were issued as a result of a field audit of M & B's business operations. By letter dated September 8, 1982, the Division scheduled an audit appointment for October 8, 1982. The period under audit was December 1, 1979 through August 31, 1982. The letter stated: "All books and records pertaining to your Sales Tax

liability for the period under audit should be available. This would include journals, ledgers, Sales invoices, purchase invoices, cash register tapes, exemption certificates and all Sales Tax records. Additional information may be required during the course of the audit."

The records made available for audit were sales tax returns and related worksheets, Federal and State income tax returns and related worksheets, depreciation schedules, a cash receipts journal, sales invoices for two test periods selected by the auditor, a check disbursements journal, a general ledger, monthly bank statements, resale certificates, exempt organization certificates and bills of lading. The auditor deemed the records to be in fair condition.

On the day of the first audit appointment, the auditor reviewed the general ledger and cash receipts journal. The auditor selected two test periods, September 1, 1981 through November 30, 1981 and June 1, 1982 through August 31, 1982, and asked M & B to provide sales invoices of nontaxable sales for these periods at the next appointment. According to the auditor, the purpose of requesting invoices for the six-month period was to "test" the sufficiency of the books and records. From this point on, the audit concerned itself only with the two test periods. All further references to the audit in this determination should be understood to apply to the test periods unless otherwise indicated.

At the second appointment, M & B provided the requested invoices. After review, the auditor determined that M & B's books and records were inadequate to verify reported taxable sales for the entire audit period. Several factors indicated the inadequacy of the books and records. Most of the sales invoices were not prenumbered, and none of them could be traced to the cash receipts journal. According to the auditor, petitioners' reported taxable sales were 12 and one-half percent of its reported gross sales. The auditor stated that he was told by petitioners' accountant that taxable sales were consistently estimated as a percentage of gross sales.<sup>1</sup>

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<sup>1</sup>M & B filed sales tax returns showing taxable sales to be 11.5739 percent of gross sales for each sales tax quarter in the period December 1, 1979 through November 30, 1981. For the period December 1, 1981 through February 28, 1982, petitioner reported taxable sales which

M & B's gross sales for the test periods as shown in its books were compared to bank statements and sales tax returns and no differences were found. Sales as shown in M & B's general ledger reconciled with M & B's gross receipts as reported on its Federal income tax returns.

Petitioners' sales invoices were grouped into five categories labeled: trucking, UPS, shipping, exempt, and wholesale sales. Sales in these categories were claimed by M & B to be nontaxable sales. The auditor visited the premises of M & B and questioned Mr. Munjal regarding M & B's records of taxable sales. He was told that retail sales made in the store were written up on an invoice and provided to the bookkeeper who totaled the invoices on a daily basis and entered the amount in a sales book. The auditor requested copies of sales invoices showing taxable sales at this time and several times thereafter, but he was never provided with them. M & B did not use a cash register capable of producing a register tape.

The auditor attempted to verify the nontaxable status of sales in each of the categories as stated above.

(a) The month of August 1982 was used as a test period for sales shipped by UPS and by truck. The auditor was able to reconcile invoices in these categories amounting to \$610,756.28 with UPS records and trucking company receipts. Sales of \$18,254.91 were found to have been delivered within New York State and were reclassified by the auditor as taxable sales.

(b) Sales categorized by M & B as "shipping" were in actuality sales for export. The auditor attempted to match individual items shown on M & B sales invoices with the same items on corresponding bills of lading used for shipment.<sup>2</sup> The bills of lading were those of

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were 11.55 percent of gross sales, and for the period March 1, 1983 through May 31, 1983, petitioner reported taxable sales which were 5.92 percent of gross sales.

<sup>2</sup>The audit report states: "Taxpayer's invoices were the bills of lading." Later, however, it states: "if the description on the bill of lading was 'One Used Refrigerator' and a refrigerator was listed on the invoice, then the refrigerator was allowed." These statements appear to be irreconcilable. Based on all the evidence in the record, it was concluded that the auditor worked from two sets of documents, sales invoices and bills of lading.

airlines and sea carriers and were prepared by M & B's customers who were shipping goods overseas. Oftentimes, the bill of lading would simply read "household goods" or would indicate that an item was "used". The auditor contacted the shippers and verified that the crates had actually been shipped overseas. The auditor treated as nontaxable sales all items which he was able to match with a comparable item on the bill of lading. M & B's sales invoices in the export category totaled \$184,434.50. The auditor was unable to trace to a bill of lading sales totaling \$139,127.50; therefore, this amount was deemed additional taxable sales for the test period.

(c) Invoices from claimed exempt sales totaled \$53,692.10. The auditor reviewed approximately 60 sales invoices claimed to represent sales to tax exempt organizations or individuals (diplomats, etc.) The auditor deemed an exempt sale to be substantiated only if a fully completed invoice was accompanied by a fully completed exemption certificate. In some instances, an exemption certificate was attached to an invoice, but the invoice had no name and address on it. For example, an invoice dated November 19, 1981 showed sales of \$279.00. There was no name on the invoice. Attached to the invoice was an exemption certificate which identified the exempt organization as the American Merchant Marine Library with an identification number provided. The auditor treated this and similar transactions as taxable sales. In other instances, it appeared that an exemption number was added after other parts of the exemption certificate were completed. These were treated as taxable sales. In some cases, M & B made several sales during the test period to the same organization or individual but obtained only one certificate. In these cases, the auditor treated as exempt only sales shown on invoices having an attached certificate. For instance, a sale made on November 15, 1981 in the amount of \$674.00 to the Freedom Church of Revelation was deemed taxable because an exemption certificate was not provided. A sale made on October 14, 1981 to the same organization was deemed nontaxable, since an exemption certificate was affixed to the invoice. Total claimed exempt sales deemed taxable by the auditor amounted to \$26,813.85.

The auditor next listed all of the invoices which M & B claimed to be nontaxable by virtue of being sales for resale. The total amount of these invoices was \$3,203,168.14. Resale

certificates provided by M & B were correlated with invoices initially substantiating nontaxable sales of \$617,489.43. The auditor then compiled from the invoices a list of 211 vendors for whom M & B had not provided a resale certificate or had provided an incomplete certificate. M & B was asked to provide completed certificates for each of these vendors. In the meanwhile, the auditor attempted to match the resale certificates already provided against the Division's computer files. He found that some of the authorization numbers were nonexistent or had been deactivated.

Approximately four months after the request was made, petitioners provided the auditor with completed resale certificates. The auditor suspected the authenticity of these certificates because much of the information on the forms was completed in the handwriting of one or two individuals. Also, the information shown on the certificates was identical to the information the auditor provided on the list of requested certificates. That is, if the auditor provided a complete name and address (which he copied from M & B sales invoices), the certificate had a complete name and address; if the auditor provided a name and no address, the certificate was completed with a name but without an address.

The auditor sent a verification letter to a random sample of the vendors for whom a resale certificate had been requested. Addresses were obtained from telephone books, the Division's computer files and the M & B sales invoices. In its entirety, the letter reads:

"Dear Sirs:

It is imperative that this office obtain information from you regarding purchases made by you from:

M & B Appliance, Inc.  
83-15 Broadway  
Elmhurst, N.Y. 11373

for the period of Sept., Oct., & Nov., 1981, and June, July, & August, 1982.

Kindly review your files to supply us with the dollar volume, by month if possible, for the months requested.

The receipt of this information in a diligent and accurate manner will negate the possibility of a field visit or use of a subpoena to verify this information.

Kindly supply this information by [date changed depending on date of letter].

If you have any questions, please feel free to call."

Some of these letters were returned to the Division stamped "Forwarding Order Expired". This caused the auditor to further question the authenticity of some of the resale certificates received from M & B, since it appeared that M & B had contacted vendors when the Division could not. Because of this, the Division decided to try to verify all sales invoices by contacting the vendor shown on the invoice. Eventually, letters requesting information regarding purchases made from M & B were sent to all of M & B's vendors. In addition, the auditor personally contacted some vendors and attempted to obtain from each a written statement indicating whether or not the resale certificate provided by M & B was authentic.<sup>3</sup> A review of the responses received indicates that of the 53 vendors contacted, 21 unequivocally denied executing the resale certificate and 7 unequivocally admitted signing the resale certificate. Others could not be located (e.g., the business was closed, moved to another location, was a private residence) or gave equivocal responses (e.g., the signature "might be" that of a departed employee) or denied executing the certificate but refused to sign a statement. In addition, some vendors who denied executing the resale certificate reported purchasing merchandise for resale, in some cases in significant amounts. For example, Mike Brody Camera denied executing the resale certificate but admitted purchasing merchandise from M & B during the test period in the amount of \$63,827.00.

The auditor substantiated \$880,367.25 in sales for resale from a total of \$3,203,168.14 claimed.

(a) Vendors responding to the verification letter reported \$615,824.46 in purchases from

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<sup>3</sup>The auditor asked vendors to complete and sign the following statement:

" [John Doe] of [John Doe Company] has examined the attached resale certificate (ST-120). I have reviewed it with all partners, officers or employees to whom the certificate could have been presented for completion.

To the best of my knowledge, the attached certificate [was] [was not] completed and signed by a partner, officer or employer [sic] of [John Doe Company]."

M & B. M & B invoices to these vendors amounted to \$1,638,818.89. Typically, the vendor responses consisted of handwritten notations placed on the bottom of the letter. Some of the responses were uninformative. For example, one vendor simply replied that it was out of business and its records were in cold storage. The auditor deemed to be substantiated nontaxable sales only the amounts reported by the vendors, except in those cases where the vendor reported purchasing more than the amount shown on M & B's invoices. In those cases, the auditor treated as substantiated only the lesser amount shown on the invoice. In this way, the auditor substantiated total nontaxable sales for the test period of \$589,373.67.

(b) The Division issued notices of determination on September 20, 1984, calculating tax due of \$332,274.56 on the basis of information available up to this point in time, primarily verifications received from M & B's customers, with no further adjustments. The auditor's handwritten notes for September 19, 1984 state: "Computed allowable exempt sales percentage. Computed disallowed taxable sales for the period 12/1/79-8/31/81." The auditor's calculations for the period December 1, 1979 through August 31, 1981 are not in the record and the factors which made up those calculations are not known with certainty. The audit continued from this point.

(c) In its cash receipts journal, M & B listed all checks received in payment for purchases and the name of the person or entity drafting the check. The auditor reviewed this journal and identified all vendors who had not responded to the verification letter who had made payments by check to M & B. M & B invoices made out to the vendors so identified amounted to \$405,893.93. Check payments from this group of vendors amounted to \$86,796.00. The latter amount was deemed to be substantiated nontaxable sales. This amounted to 33.069 percent of the amount shown on the invoices.

(d) At the beginning of the audit, M & B had provided some resale certificates. Initially, the auditor correlated the certificates with invoices to substantiate nontaxable sales of \$617,489.43. The auditor now determined that only 33.069 percent, or \$204,197.58, of these should be allowed as nontaxable sales.



(e) The auditor added all substantiated nontaxable sales: \$589,373.67 as verified by vendors purchasing from M & B; \$86,796.00 in additional payments by check as verified through M & B's cash receipts journal; and \$204,197.58, representing a percentage of those sales for which resale certificates were originally provided. This resulted in substantiated sales for resale of \$880,367.25. This amount was added to substantiated nontaxable sales in the other categories of sales yielding total substantiated nontaxable sales for the test period of \$1,545,054.00. Reported nontaxable sales for the same period were \$4,105,105.00. The auditor then calculated an error rate of 62.36 percent. The error rate was applied to reported nontaxable sales for the period December 1, 1979 through August 31, 1981 to calculate additional taxable sales of \$3,701,179.00 with a tax due on this amount of \$296,094.32, and a notice of assessment review was issued for that period. The Division decided to update the audit period by including the period September 1, 1982 through August 31, 1983. Therefore, the auditor then applied the error rate to reported nontaxable sales for the period September 1, 1981 through August 31, 1983 to calculate additional taxable sales of \$9,685,483.00 with a tax due on this amount of \$799,052.35.

During the course of the audit, there were several contacts between the Division and petitioners. Petitioners questioned the accuracy of the information received by the Division from M & B's customers. M & B's overall claim was that the customers were only reporting purchases made by check, which were verifiable by the Division, and were not reporting purchases made in cash. The Division analyzed records maintained by M & B to weigh this contention. The Division was told that M & B deposited all checks it received in a State Bank of India account while currency was deposited in an account with the European American Bank (EAB). A comparison of deposits in these two accounts showed that 71.11 percent of total receipts were deposited in the State Bank of India Account (the account used for checks) while 28.89 percent of total receipts were deposited in the EAB account (used for currency). From this, the auditor concluded that less than one-third of M & B's sales were paid in cash, with the remainder being paid by check. This undermined M & B's argument that its customers tended

to pay in cash and had understated cash purchases when reporting to the Division.

To exemplify its claim that vendors were not accurately reporting purchases, M & B's representative pointed to four customer accounts which showed significant differences between cash purchases and purchases by check.

<u>Customer</u>	<u>Sales Per Invoices</u>	<u>Sales Per Customers</u>	<u>Payments By Check</u>
Ing Stereo Mall	\$ 10,398	\$ 7,440	\$ 850
Mike Brody Camera	87,829	63,827	3,087
Rafik Appliance	146,420	70,440	51,114
Ulster Electronics	36,268	10,941	6,768

Since the figures showed that each of the four customers had reported to the Division a substantial amount of cash purchases, the Division concluded that M & B's records did not support its argument that vendors were only reporting purchases made by check.

During the audit period, M & B's annual gross receipts per its Federal income tax returns increased from \$2,814,144.00 for the fiscal year ended June 30, 1980 to \$8,030,486.00 for the fiscal year ended June 30, 1982. According to M & B, this large increase in the volume of its sales resulted from a change in the way it did business. M & B began doing business as a candy store in 1974. It evolved into a retail appliance and luggage store, selling merchandise for export, mainly to European and Indian nationals (see Matter of M & B Appliances, State Tax Commission, April 25, 1984 [TSB-H-87(220)S]). By 1982, M & B had developed a large wholesale business. It was the authorized distributor for products manufactured by SONY, Panasonic, Samsonite and others. It also continued operating a retail store.

During the audit period, M & B employed approximately seven people, two of whom were delivery persons. M & B operated its wholesale business on a cash and carry basis. The delivery person not only delivered merchandise but also collected payment for merchandise delivered. These payments consisted of cash, or currency, checks drawn on the retail vendor's bank account and third-party checks, usually checks received by the vendor from its own customers and used to pay M & B. It was M & B's practice to list in its cash receipts journal,

the name of the drawer of every check it received, the date the check was received and the amount of the check. The M & B delivery person receiving the check initialed it. This enabled M & B to trace any third-party checks returned for insufficient funds to the vendor who gave it to M & B in payment. M & B could then collect the amount of the check from the vendor. M & B did not extend lines of credit to its customers. It did accept postdated checks which were not deposited until several days after the date of the sale. In some cases, M & B would deposit a check although its customer had informed M & B that funds in the customer's account were insufficient to cover the amount of the check. When the check was returned, M & B would return to the customer to collect the payment in cash. At other times, M & B held checks for several days knowing the customer had insufficient funds to cover the check. The check served as a form of collateral and would be returned to the customer upon receiving payment in cash. These business practices explain the large number of checks listed in M & B's cash receipts journal and the large amount of the deposits in the State Bank of India account used for checks.

In maintaining its own books and records, M & B did not segregate its sales receipts into taxable and nontaxable categories. M & B's accountant testified that neither M & B's sales invoices nor its cash receipts journal identified its retail sales or separated retail and wholesale sales. M & B's accountant estimated M & B's reported taxable sales, using a methodology taught to him by the prior accountant.

Mr. Munjal explained how M & B had obtained the requested resale certificates. Two or three salesmen had completed the portion of the certificates that asks for the seller's and purchaser's name and address. They then personally contacted the vendors, asking them to sign the certificates and provide an authorization number.

Petitioners pointed to approximately 40 vendor responses to demonstrate that the vendor responses were an unreliable basis for assessing tax.

(a) The response from vendor number 27<sup>4</sup> indicates that the vendor's name is B & B

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<sup>4</sup>The response number refers to a control number assigned to each vendor by the auditor. It allowed the auditor to cross-reference M & B sales invoices, resale certificates, responses to the verification letter and statements by the vendors regarding the authenticity of the resale

Refining located at 63-61 99th Street, Rego Park, while the auditor's workpapers show vendor number 27 to be B & B Custom Institute located at 62-60 99th Street, Rego Park.

(b) Several vendors for whom M & B provided resale certificates reported that they had made no purchases from M & B (vendor numbers 67, 178, 238 and 321). It is petitioners' position that the resale certificates are valid and would not have been given to M & B if the vendor had not purchased from M & B.<sup>5</sup>

(c) Vendor number 69 admitted making purchases of \$4,987.00 during the period ended August 31, 1982 but claimed that the signature on the resale certificate was not his. M & B invoices showed purchases by this vendor in the amount of \$7,409.00. The auditor treated as substantiated purchases in the amount of \$4,987.00.

(d) Vendor number 79 indicated that its goods were purchased from M & B on consignment, and only \$1,893.00 worth of goods were actually kept by the vendor and paid for. M & B's invoices showed purchases of \$12,546.00 by this vendor. Apparently, it is petitioners' position that the full amount of goods transferred on consignment to vendor number 79 should have been treated as sales for resale.

(e) Vendor number 83 stated that it had no records of ever purchasing any goods from M & B. Petitioners note that the auditor's workpapers show nontaxable purchases by vendor number 83 in the amount of \$20,611.00 and that the vendor submitted a valid resale certificate. Vendor number 83 was among that first group of vendors for whom M & B provided certificates at the outset of the audit. The auditor's workpapers referred to by petitioners contain information taken from M & B's records. The information regarding vendor number 83 was not verified by the vendor; therefore, the auditor treated all sales allegedly made to vendor number 83 as taxable. Petitioners made similar arguments regarding vendor numbers 112 and 235.

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certificates.

<sup>5</sup>Three of the vendors in question each denied that it had executed the resale certificate provided to the Division by M & B.

(f) Vendor number 183 reported purchasing approximately \$104,000.00 worth of goods from M & B. M & B invoices showed purchases of \$105,031.65. The auditor treated only \$104,000.00 as substantiated sales for resale.

(g) The verification letter from vendor number 161 has penciled notations on it consisting of a series of numbers. Petitioners argue that the penciled notations serve to verify a higher amount of nontaxable sales than the amount treated as nontaxable by the auditor. The penciled notations appear to be those of the auditor; the sum of those numbers is equal to the amount shown on the M & B invoices. The vendor reported purchasing a smaller amount than that shown on M & B invoices, and the auditor treated as substantiated nontaxable sales only the amount verified by the vendor.

(h) In several instances, the vendor reported having made purchases from M & B within several days or weeks of the test periods (vendor numbers 201 and 263). The auditor disregarded these purchases. Petitioners argue that these purchases should have been considered in determining nontaxable sales by M & B.

(i) Petitioners claim that the auditor's practice of combining the invoices of vendors operating with the same name out of several locations worked to M & B's detriment. They use as an example vendor numbers 250 and 256. The response from vendor number 256, located on 37th Avenue in Woodside, New York, indicated purchases of \$8,285.00. A letter to vendor 250, operating under the same name on Division Street, was not responded to. The auditor's notations indicate some uncertainty regarding the proper allocation of the amounts shown on M & B's invoices to the two vendors. In the end, the auditor treated \$8,285.00 as substantiated nontaxable sales. Apparently, there were one or more sales invoices totaling \$1,480.00 written to either vendor 250 or 256 which the auditor did not treat as nontaxable. Petitioners pointed out similar problems with regard to vendor numbers 233, 268, and 272.

(j) The failure of a vendor to respond completely to the Division's verification letter worked to M & B's detriment. Vendor number 151 replied in a manner which was unresponsive to the Division's letter and indicated that the vendor did not fully understand the

Division's request. An employee of vendor number 182 called the Division stating that "the boss" was away from the business and offering to respond to the letter within four weeks. A reply was never received. Vendor number 197 replied: "Sales made to this firm have been minimal and are not recorded separately as this firm is not a regular customer. As such, it is not practical to research our records for the periods in question as it would involve finding a couple of transactions among thousands." M & B invoices show purchases by vendor number 197 of \$20,254.00 during the test periods. Vendor number nine replied: "ACO is out of business due to lack of business. Our records are in cold storage." M & B invoices show purchases by vendor number nine of \$5,580.00 during the test periods. In each of these instances, the auditor treated M & B's records as unsubstantiated.

#### SUMMARY OF PETITIONERS' POSITION

Petitioners argue that M & B maintained adequate books and records as required by section 1135 of the Tax Law. Since they maintain that M & B's records were adequate for audit purposes, they take the position that the use of a test period audit was arbitrary and capricious. They further maintain that the auditor resorted to a test period audit without first inspecting the complete books and records for the entire audit period as required.

Petitioners contend that the audit methods employed were not reasonably calculated to reflect the taxes due.

(a) Petitioners argue that the responses the Division received to the verification letters are unreliable on their face. In the vast majority of cases the responses were not signed, the basis for the vendor's statements was not provided and the auditor could not know whether the vendor maintained accurate records of its purchases. Petitioners contend that the Division should have investigated further to determine the accuracy of the books and records of at least a sampling of the third-party vendors before relying on them as a basis for the determination of additional tax due.

(b) Petitioners argue that the auditor acted arbitrarily in disallowing certain exempt sales. The auditor disallowed sales where the exempt organization number was inserted on a carbon

copy of a resale certificate. He allowed sales to an exempt organization where an exempt organization certificate was attached to the sales invoice, but disallowed sales to the same organization within the test period if a separate certificate was not attached to the invoice.

(c) Petitioners contend that the Division's methodology for substantiating export sales was arbitrary, essentially because that methodology relied on the bill of lading prepared by M & B's customers to provide sufficient detail to enable the auditor to trace the items shown on the bill of lading to the attached invoice.

### CONCLUSIONS OF LAW

A. As a vendor of tangible personal property, M & B was responsible for collecting sales tax on its retail sales (Tax Law § 1132[a]). M & B was also obligated to keep records of every sale and the tax due thereon, including "a true copy of each sales slip, invoice, receipt, statement or memorandum" provided to its customer in accordance with Tax Law § 1132(a) (Tax Law § 1135[a]). Furthermore, M & B was required to separately state the tax due on any invoice or sales slip provided to the customer (Tax Law § 1132[a]).

The Division has the authority to determine, "from such information as may be available," the amount of tax actually due from a taxpayer for a given period when any one of its sales tax returns is either not filed or states an incorrect or insufficient amount of tax due (Tax Law § 1138[a][1]). When the vendor maintains a comprehensive set of books and records, "such information as may be available" (Tax Law § 1138[a][1]) is restricted to his books and records, and not external indicia, because "[t]he honest and conscientious taxpayer who maintains comprehensive records as required has a right to expect that they will be used in any audit to determine his ultimate tax liability" (Chartair, Inc. v. State Tax Commn., 65 AD2d 44, 411 NYS2d 41, 43).

To determine the adequacy of a taxpayer's records, the Division must first request (Matter of Christ Cella v. State Tax Commn., 102 AD2d 352, 477 NYS2d 858, 859) and thoroughly examine (Matter of King Crab Restaurant v. State Tax Commn., 134 AD2d 51, 522 NYS2d 978, 979-80) the taxpayer's books and records for the entire period of the proposed assessment

(Matter of Adamides v. Chu, 134 AD2d 776, 521 NYS2d 826, 828, lv denied 71 NY2d 806, 530 NYS2d 109). The purpose of the examination is to determine, through verification drawn independently from within these records (Matter of Meyer v. State Tax Commn., 61 AD2d 223, 402 NYS2d 74, 76, lv denied 44 NY2d 645, 406 NYS2d 1025; Matter of Giordano v. State Tax Commn., 145 AD2d 726, 535 NYS2d 255, 256-57; Matter of Urban Liquors, Inc. v. State Tax Commn., 90 AD2d 576, 456 NYS2d 138, 139; see also, Matter of Hennekens v. State Tax Commn., 114 AD2d 599, 494 NYS2d 208, 209), that they are, in fact, so insufficient that it is "virtually impossible [for the Division of Taxation] to verify taxable sales receipts and conduct a complete audit" (Chartair, Inc., supra, at 43; Matter of Christ Cella v. State Tax Commn., supra), "from which the exact amount of tax due can be determined" (Matter of Mohawk Airlines, Inc. v. Tully, 75 AD2d 249, 429 NYS2d 759, 760).

Where the Division follows this procedure, thereby demonstrating that the records are incomplete or inaccurate, the Division may resort to external indices to estimate tax (Matter of Urban Liquors, Inc. v. State Tax Commn., supra). The estimate methodology utilized must be reasonably calculated to reflect taxes due, but exactness is not required from such a method (Matter of W. T. Grant Company v. Joseph, 2 NY2d 207, 159 NYS2d 150, 157, cert denied 355 US 869; Matter of Markowitz v. State Tax Commn., 54 AD2d 1023, 388 NYS2d 176, 177).

B. The first issue to be addressed is whether the Division made an adequate request for all books and records for the period of assessment. The original audit period was December 1, 1979 through August 31, 1982. The audit appointment letter was a clear and unequivocal request for all books and records for that period (see, Matter of Great Neck Service Station, Tax Appeals Tribunal, May 26, 1988). However, there is no evidence that M & B was asked to produce records for any period beyond that ending August 31, 1982; therefore, the assessments for the period September 1, 1982 through August 31, 1983 must be cancelled. Without a specific request for the records for the latter period, it is not possible to determine the adequacy of these records, and the resort to the results of the test period audit to estimate tax for this period was improper (Matter of Adamides v. Chu, supra; Matter of Anton's Car Care Center,



Ltd., Tax Appeals Tribunal, November 23, 1988; Matter of Ahmed S. Ahmed and Yahya Ahmed d/b/a A & A Grocery Store, Tax Appeals Tribunal, November 10, 1988). The remainder of this determination will address only the period December 1, 1979 through August 31, 1982, the original audit period.

C. The next issue to be addressed is whether the auditor conducted a sufficient examination of M & B's books and records for the original audit period to support the conclusion that the records were inadequate.

Petitioners' position is that the auditor was required to examine the books and records for the entire audit period before concluding that those books and records were inadequate for the purpose of conducting a complete audit. Petitioner cites to the opinion in Matter of King Crab Restaurant v. Chu (134 AD2d 51, 522 NYS2d 978, 979) where the court stated:

"The auditor did not make a sufficient investigation of the records made available to him to justify his conclusion that the records were incapable of supporting a complete audit. As a result, the estimate procedures adopted were arbitrary and capricious and lacked a rational basis (citations omitted)".

The court's language makes it clear that the question is not whether books and records for the entire audit period were actually inspected in detail, but whether the auditor's investigation was sufficient to support a conclusion that the records for the entire period were not sufficient for audit purposes. Ordinarily, an inspection of books and records for only a portion of the audit period would not support such a conclusion ( see, Matter of Giacomo Brancato, Tax Appeals Tribunal, November 10, 1988). Here, however, the record taken as a whole supports the conclusion that the auditor reasonably determined that M & B's records were insufficient to support a complete audit.

The record clearly demonstrates that M & B's records were inadequate for audit purposes. M & B's accountant testified that M & B estimated its taxable sales as a percentage of its gross sales. M & B's sales invoices did not state the tax due on those sales which M & B considered to be retail sales. In fact, it was admitted at hearing that M & B kept no independently verifiable record of its taxable sales as required by sections 1132(c) and 1135(a) of the Tax Law. Since such records were lacking, M & B's sales records were inadequate (see, Matter of

Goldner v. State Tax Commn., 70 AD2d 978, 418 NYS2d 477, lv denied 48 NY2d 608, 423 NYS2d 1025).

Furthermore, the auditor's investigation was sufficient to justify his conclusion that M & B's books and records would not support a complete audit. At the first audit appointment, the auditor inspected M & B's general ledger and cash receipts journal. These books did not segregate taxable and nontaxable sales. Later in the audit, the auditor requested sales invoices showing taxable sales and was never provided with them. M & B conducted business without a cash register that produced a tape and thus had no cash register tapes to provide. Furthermore, the auditor was told by representatives of M & B that taxable sales were estimated as a percentage of gross sales. The auditor's testimony and the audit report confirm that M & B's failure to keep verifiable records of taxable sales formed the basis, at least in part, for his conclusion that M & B's records were inadequate for audit purposes. Accordingly, a reasonable basis existed for the auditor's conclusion that M & B's books and records were inadequate, and the Division justifiably resorted to the results of the test period audit to determine the tax due for the audit period (cf., Matter of Cafe Europa, Tax Appeals Tribunal, July 13, 1989).

D. Since the resort to a test period audit was justified, the next issue to be addressed is whether petitioners met their burden of demonstrating by clear and convincing evidence that the method of audit or the amount of the tax assessed was erroneous (Matter of Surface Line Operators Fraternal Organization, Inc. v. Tully, 85 AD2d 858, 446 NYS2d 451).

In this case two statutory notices of determination were issued. The first notice was issued before the audit was completed in order to avoid the expiration of the statute of limitations on assessment provided for in Tax Law § 1147(b). Of course, a statutory notice may not be issued solely to stop the running of the statute of limitations without any other basis (see, Matter of Hair and Nails, State Tax Commission, November 7, 1985 [TSB-H-86(10)S]; Matter of William G. Miley, Jr., State Tax Commission, October 30, 1985 [TSB-H-85(247)]). Moreover, "proof gathered after the assessment is issued which indicates that the assessment is reasonable does not eliminate the requirement that an assessment be based upon such

information as may be available at the time the [statutory] notice is issued" (Matter of Theresa Roncone, State Tax Commission, March 11, 1986 [TSB-H-86(83)S]). Evidence in the record, including the auditor's testimony suggests that the first statutory notice was issued based upon the information available to the auditor at that time, primarily third-party verification received from M & B's customers. However, the exact basis of the auditor's calculations is not in the record. It appears that the auditor did not take several categories of claimed nontaxable sales into account in arriving at a determination of tax due, i.e., trucking, UPS, and export sales. Without evidence in the record of the auditor's calculation of additional taxable sales for the period December 1, 1979 through August 31, 1981, there is no basis for a conclusion that the auditor's calculations had a rational basis. Consequently, the notice of determination issued on September 20, 1984 must be canceled.

E. Petitioners argue that the Division's methodology for substantiating M & B's resale sales was inherently unreliable and, therefore, not reasonably calculated to determine the tax due. For the years in issue, Tax Law § 1132(c) provided:

"For the purpose of the proper administration of this article and to prevent evasion of the tax hereby imposed, it shall be presumed that all receipts for [tangible personal] property...are subject to tax until the contrary is established, and the burden of proving that any receipt...is not taxable hereunder shall be upon the person required to collect tax or the customer. Unless (1) a vendor shall have taken from the purchaser a certificate in such form as the tax commission may prescribe, signed by the purchaser and setting forth his name and address and, except as otherwise provided by regulation of the tax commission, the number of his registration certificate, together with such other information as said commission may require, to the effect that the property or service was purchased for resale or for some use by reason of which the sale is exempt from tax under the provisions of section eleven hundred fifteen.... Where such a certificate has been furnished to the vendor, the burden of proving that the receipt...is not taxable hereunder shall be solely upon the customer."

A vendor who receives a resale certificate in good faith is insulated from sales tax liability, even if that certificate later is found to have been issued without authority (Matter of RAC Corporation v. Gallman, 39 AD2d 57, 331 NYS2d 945; see also, Matter of Saf-Tee Plumbing v. Tully, 77 AD2d 1, 432 NYS2d 409). The crux of petitioners' argument is that since it provided resale certificates from its vendors to the Division, the Division had no basis for deeming the sales M & B claimed were for resale to be taxable.

The auditor attempted to verify the authenticity of the resale certificates provided by M & B by personally contacting a random sample of the vendors who purportedly gave the certificates to M & B. This yielded inconclusive results at best. Vendors who denied signing the certificates admitted purchasing merchandise for resale from M & B, in some cases in significantly large amounts. Vendors who admitted purchasing from M & B, when asked to verify the resale certificates, either denied making any purchases during the test periods in response to the purchase verification letter or failed to respond at all. Other vendors were out of business or could not be located. In the face of this, the auditor, in effect, treated all of the resale certificates as null and void. That is, the existence of a resale certificate, adequate on its face and not proven to be falsified, did not insulate M & B from tax liability, nor did a vendor's denial that he had executed the proffered certificate result in a finding that all sales to that vendor were taxable. Instead of relying on the resale certificates to determine whether a sale was or was not subject to tax, the auditor relied almost entirely on the responses to the Division's purchase verification letter.

Petitioners persuasively argue that this methodology was inherently unreliable. The vendors did not explain how they arrived at the figures they reported to the Division or describe their recordkeeping system. The auditor did not examine the books and records of M & B's customers and could not have known whether the figures reported were accurate. The responses displayed no outward indicia of reliability; typically, the verification letters were returned with figures scrawled on the bottom of the Division's letters. Some vendors gave contradictory and incomplete responses, demonstrating a complete lack of dependability. The failure of a vendor to respond to the purchase verification letter or an outright refusal by a vendor to review his own books and records resulted in a finding that all sales to that vendor were taxable sales.

This case is distinguishable from those decisions which have affirmed the use of third-party verification of purchases to determine taxable sales (see, e.g., Matter of Double B. Auto, Tax Appeals Tribunal, September 1, 1988; Matter of A. Charles Cinelli, Tax Appeals Tribunal,

September 14, 1989). In those cases, the taxable status of the taxpayers' sales was not in issue; rather, the cases turned on the taxpayers' failure to keep adequate records of gross sales. In contrast, M & B provided the Division with sales invoices, a cash receipts journal, a general ledger and bank statements which generally reconciled. Those records were deemed reliable for the purpose of verifying M & B's gross sales, and the only issue raised on audit involved the taxable status of M & B's sales.

To overcome the presumption of taxability of its sales, M & B provided the Division with resale certificates. The Division effectively ignored these certificates and proceeded on the theory that all sales which could not be verified by a third-party vendor as sales for resale were, in fact, taxable sales. Such a methodology is inconsistent with section 1132(c) of the Tax Law and 20 NYCRR 532.4(c)(2) which set forth the criteria which must be met by a vendor to overcome the presumption of taxability through the use of resale certificates. The Division had the authority to treat as invalid those resale certificates which failed to meet the criteria set forth in the statute and regulation and to treat all M & B sales for which a valid resale certificate was not provided as taxable. It did not do so. Therefore, it is found that M & B overcame the presumption of taxability by providing resale certificates as provided for in section 1132(c).

F. Petitioners contend that the Division's disallowance of certain claimed exempt and export sales was arbitrary.

Vendors are required to maintain sales records which must "provide sufficient detail to independently determine the taxable status of each sale and the amount of tax due and collected thereon or may be substantiated by analysis of supporting records" (20 NYCRR 533.2[b][2]). When a vendor makes a sale to a purchaser who is exempt from sales tax and obtains and retains a properly completed exemption certificate at the time of the sale, he is deemed to have met his burden of proof to show that the sale was not subject to tax (20 NYCRR 532.4[b][2]). Petitioners maintain that they provided the auditor with sales invoices and exemption certificates substantiating the exempt status of the sales they claimed to be exempt.

The auditor treated certain of M & B's claimed exempt sales as taxable for a variety of

reasons. For example, M & B may have obtained one properly completed exemption certificate from a purchaser and thereafter treated all sales to that purchaser as exempt without obtaining another certificate. An attached exemption certificate might have a proper identification number on it and be signed by the purchaser but lack a name and address.

In a discussion of resale certificates, the court in Matter of RAC Corporation v. Gallman (supra), held that in determining the adequacy of those certificates substance as well as form must be considered (see also, Matter of Steelcase, Inc., State Tax Commission, July 3, 1988 [TSB-H-87(219)S]). The same principle applies to exemption certificates or any other documentation offered to overcome the presumption of taxability. Here, it would appear that form rather than substance controlled the Division's determination. Sales to an exempt organization or person were deemed nontaxable only if the sales invoice and exemption certificate were completely filled out, in total conformity, and appeared to have been contemporaneously prepared. Sales to the same organizations or person were deemed taxable, if, for instance, M & B relied on a certificate on file rather than obtaining a second certificate to prove nontaxability. In almost all cases, the Division was presented with an invoice and attached exemption certificate or an invoice with an exemption number written on it which could be correlated with a certificate kept on file or attached to another invoice. These records were adequate to overcome the presumption of taxability.

Likewise, petitioners established the existence and amounts of claimed export sales. M & B maintained sales invoices and bills of lading to verify its export sales. The auditor deemed taxable any invoice items he was unable to trace to the bills of lading. However, the bills of lading were prepared by the purchasers of the merchandise, not M & B. M & B prepared the sales invoices which were adequate to verify the sales and maintained the bills of lading as evidence that the merchandise shown on the sales invoice was exported. There is no evidence to suggest that there was any fraud involved here. In fact, the auditor confirmed by contacting the shipping companies that the crates of merchandise from M & B were actually shipped outside the country. Under these circumstances, petitioners carried their burden of proof to

show that M & B's "shipping" sales were not delivered in New York State.

G. The petitions of M & B Appliance, Inc., Man M. Munjal and Inder S. Bindra are granted, and the notices of determination and demands for payment of sales and use taxes due issued on September 20, 1984 and August 27, 1985 are canceled.

DATED: Troy, New York

ADMINISTRATIVE LAW JUDGE